

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

|  |   |                      |
|--|---|----------------------|
| In the Matter of                             | ) |                      |
|  | ) |                      |
| Section 272(f)(1) Sunset of the BOC Separate | ) | WC Docket No. 02-112 |
| Affiliate and Related Requirements           | ) |                      |
| Interstate Special Access Services           | ) |                      |
|  | ) |                      |
| 2000 Biennial Regulatory Review              | ) | CC Docket No. 00-175 |
| Separate Affiliate Requirements of Section   | ) |                      |
| 64.1903 of the Commission's Rules            | ) |                      |

**COMMENTS OF AD HOC  
TELECOMMUNICATIONS USERS COMMITTEE**

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**COMMENTS OF THE AD HOC  
TELECOMMUNICATIONS USERS COMMITTEE**

The Ad Hoc Telecommunications Users Committee (the "Ad Hoc Committee") submits these Comments pursuant to the Commission's May 19, 2003 Further Notice of Proposed Rulemaking ("*FNPRM*") in the dockets captioned above.<sup>1</sup> As detailed in the following paragraphs, Ad Hoc urges the Commission to impose accounting safeguards and other regulatory protections on the in-region, interexchange, interstate and international services (hereinafter, "long distance services") of the Bell Operating Companies and other incumbent local exchange carriers (collectively, the "ILECs") in order to prevent those carriers from impeding or restricting competition for those services. In addition,

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<sup>1</sup> Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements, WC Docket No. 02-112, and 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules, CC Docket No. 00-175, Further Notice of Proposed Rulemaking, rel. May 19, 2003, FCC 03-111 ("*Further Notice*").

the Commission should retain, and in some areas strengthen, its regulation of local exchange and exchange access services to protect competition in both long distance markets and the local markets upon which long distance service competitors depend.

## **DISCUSSION**

The members of the Ad Hoc Telecommunications Users Committee ("Ad Hoc") are companies with a common attribute: the success of their businesses depends significantly upon the availability of reliable, competitively-priced telecommunications services. Ad Hoc has no members who are carriers and, though its positions may occasionally coincide with those of carriers, it advocates only those public policy and regulatory outcomes that protect the interests of end users by fostering competition where it is possible and relying on regulation only where it is not. Currently, the members of the Committee are 3M, American Express Company, Bank Of America, Cargill, Convergys, EDS Corporation, Fidelity Investments, First Data Corporation, Fiserv, Inc., Ford Motor Company, IBM Global Services, J.C. Penney Company, Liberty Mutual Insurance, Morgan Stanley, PricewaterhouseCoopers, Procter & Gamble, Sabre, State Farm Insurance, United Parcel Services, and the United States Automobile Association.

Because they are the high-volume purchasers of telecommunications services whose business carriers value highly, Ad Hoc members would likely be the first beneficiaries of any de-regulatory regime for the ILECs' long distance services and would therefore be the first to urge de-regulation of those services if

ILEC local access and exchange access markets were competitive. But local markets are not yet sufficiently competitive for market forces to discipline prices and stimulate demand-responsive service innovation. As a result, ILECs have the ability to leverage their market power in the local exchange and exchange access markets in order to obtain anti-competitive advantages in long distance markets. Accordingly, the FCC must not abdicate its responsibility to protect end-users and consumers from the supracompetitive prices and sluggish carrier performance that would result if the ILECs are classified prematurely as non-dominant in the provision of long distance services. The Commission must instead adapt its regulatory regime to the competitive realities of local and long distance markets and protect the interests of consumers.

#### **I. LOCAL MARKETS ARE NOT EFFECTIVELY COMPETITIVE**

As Ad Hoc has demonstrated in a number of pleadings filed in FCC proceedings on competitive market issues,<sup>2</sup> effective competition in the provision of the local exchange and exchange access services used by enterprise customers has simply failed to materialize, despite the competitive hopes and vision of Congress and the FCC seven years ago. The extremely limited competitive alternatives available to business end users – and to the IXC's who

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<sup>2</sup> See comments filed by Ad Hoc in response to *Performance Measurements and Standards for Interstate Special Access Services*, CC Docket Nos. 01-321, 00-51, 98-147, 96-98, 98-141, 96-149, 00-229, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001) ("*Performance Standards Rulemaking*"); *Review of Regulatory Requirements for Incumbent LEC Broadband Services*; *SBC Petition for Expedited Ruling That It Is Non-Dominant in its Provision of Advanced Services and for Forbearance From Dominant Carrier Regulation of These Services*, CC Docket No. 01-337, Notice of Proposed Rulemaking, FCC 01-360, 16 FCC Rcd 22745 (2001) ("*Wireline Broadband Dominance Rulemaking*"); *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, CC Docket Nos. 02-33, 95-20, and 98-10, Notice of Proposed Rulemaking, 17 FCC Rcd 3019 (2002) ("*Broadband Wireline Internet Access Rulemaking*").

provide long distance services to them – have proven to be wholly insufficient to discipline the BOCs' prices for local service or to protect end users from unjust and unreasonable prices, terms, and conditions. These competitive conditions create innumerable opportunities for the ILECs to restrict or impede competition in the long distance services market by leveraging their competitive position in local services markets to the benefit of their long distance operations.

Accordingly, the FCC cannot classify the ILECs' in-region long distance services as non-dominant when provided on an integrated basis and still ensure that the statutory objectives of the Communications Act are met.

The Ad Hoc pleadings identified above, which are hereby incorporated by reference, described a number of factors that stand in the way of effective competition in the local exchange and exchange access markets:

- The Commission's deregulation of the ILECs' prices for special access services (which are crucial inputs for the long distance competitors of the ILECs) has resulted in price *increases* for those services, despite record earnings by the ILECs, a result that is fundamentally inconsistent with the outcome of a market with effective competition.
- Ad Hoc's members – whose combined annual spend in the billions of dollars for telecommunications services makes them the first customers new entrants would seek out – have in fact experienced few competitive alternatives for their exchange and exchange access service requirements.
- Intermodal competition via cable modem service is not a factor for large business users due to the limited deployment of cable infrastructure in business areas and the severe security and reliability concerns raised by cable-based services and technologies.
- Meanwhile, the capital markets for competitive LECs ("CLECs") as a whole have crumbled over the past few years, driving many CLECs out of the market or into bankruptcy and placing severe restrictions on the ability of the few remaining CLECs to stay in the market, let alone expand their service capabilities.

- By contrast, the financially secure ILECs have refrained from aggressively pursuing out-of-region local markets, notwithstanding the specific “commitments” by both SBC and Verizon to do so in exchange for FCC approval of their respective merger applications.<sup>3</sup>

The first of these factors – ILEC increases in access prices upon receiving pricing flexibility under the Commission’s rules – is a particularly troubling competitive barometer. As Ad Hoc pointed out in its earlier pleadings, higher rates in markets where the Commission has granted the ILEC Phase II pricing flexibility under Section 69.701, *et seq.* of its rules is an outcome exactly opposite to what a competitive market would produce, and completely consistent with a market in which the ILECs are maintaining their legacy market power.<sup>4</sup> Yet Ad Hoc’s earlier analysis of the ILECs’ pricing behavior was recently confirmed and fortified by additional evidence submitted by AT&T in support of its petition for reform of ILEC special access rates.<sup>5</sup> As the record in that proceeding demonstrates, where ILECs have been granted Phase II pricing flexibility, they have increased, not decreased, their prices for high capacity services; in many cases, those prices are now higher than the prices in areas still regulated under price caps.<sup>6</sup>

The Commission’s own data confirms the dearth of competitive

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<sup>3</sup> *In re Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer Control of Corporation Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission’s Rules*, CC Docket 98-141, Memorandum Opinion and Order, 14 FCC Rcd 14712 (1999).

<sup>4</sup> See Comments of Ad Hoc Telecommunications Users Committee in *Performance Standards Rulemaking*, *supra* note 2, filed February 12, 2002, at 2-3 (citations omitted).

<sup>5</sup> See *Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM 10593, filed October 15, 2002, (“AT&T Special Access Petition”).

alternatives experienced by Ad Hoc members. Analyses of the actual share of the local service market controlled by the ILECs often fail to recognize that the vast majority of customer lines served by CLECs are actually provisioned over leased ILEC facilities – only about 25% of total CLEC lines are provisioned over CLEC facilities. The Commission’s own “Local Competition Report” released just this month heralds that 13.2% of the total 188-million end user switched access lines were provisioned by CLECs at the end of 2002.<sup>7</sup> As encouraging as that statistic sounds, it masks the fact that only 6.4-million<sup>8</sup> of the 188-million end user lines (3.4% of the total) are provisioned over CLEC-owned facilities. – meaning that at the time of the report, five full years after the passage of the Act, at a time when 271 Authority had been or was shortly to be granted to RBOCs in 41 of the 50 states, 96.6% of all end user access lines were being served over a wire owned by an Incumbent rather than a Competitive Local Exchange Carrier.

In the absence of competitive alternatives, enterprise networks (and large users generally) are dependent on ILEC access services and are particularly vulnerable to anti-competitive price increases or other ILEC attempts to leverage their local service market power in order to gain an anti-competitive advantage or fund anti-competitive practices in long distance markets. As the Commission itself observed in the instant *NPRM*, the Commission’s pricing flexibility rules,

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<sup>6</sup> See Declaration of Joseph M. Stith, *AT&T Special Access Petition* at Tab C (“*Stith Declaration*”).

<sup>7</sup> *Federal Communications Commission Releases Data on Local Telephone Competition: Customer Lines Reported by New Entrants Totaled 25-Million at end of 2002, Represents 13% of Total Access Lines*, released June 13, 2003.

<sup>8</sup> *Local Telephone Competition: Status as of December 31, 2002*, Federal Communications Commission, IATD, Wireline Competition Bureau, Released June, 2003, Table 10.



cited above, are not based upon a finding of non-dominance for a carrier's access services. Because those services are crucial inputs for the long distance carriers who compete with the ILECs' long distance services, the ILECs' dominance in the market for those services creates both the opportunity and powerful incentives to engage in anti-competitive practices absent regulatory oversight by the Commission.

## **II. POTENTIAL COMPETITION CANNOT CONSTRAIN THE ILECS' EXERCISE OF LOCAL MARKET POWER**

The Commission should reject any claims by the ILECs (or other commentors) that the market prices for the ILECs' local exchange and exchange access services can be held to competitive levels by potential competitive entry. This argument has been raised by the ILECs in a variety of state and federal proceedings considering regulatory declassification and/or pricing flexibility for competitive services, and it remains invalid relative to local exchange service.

### **A. The "Contestability Theory" is Inapplicable to Markets with the Cost Characteristics of Local Exchange and Exchange Access Markets**

The general thrust of the "contestability theory" underlying the ILECs' potential competition arguments is that, even without competitors actively participating in the market, the threat of competitive entry alone is sufficient to discipline an otherwise monopolistic firm (e.g., an ILEC with virtually 100% market share) from raising its prices to supracompetitive levels.<sup>9</sup> Contestability theory has been debated by economists since its original development by William

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<sup>9</sup> Jean Tirole, *The Theory of Industrial Organization*. Cambridge, MA: MIT Press (1988).

Baumol in the early 1980s,<sup>10</sup> and it has undoubtedly broadened the possible range of regulatory responses to markets with natural monopoly characteristics.<sup>11</sup> Nevertheless, it has not succeeded in overturning the mainstream view that actual competitive entry (or in the alternative, regulatory intervention) is necessary to constrain pricing in situations where incumbents hold substantial market power.<sup>12</sup>

The principle liability of the contestability theory for real-world application is that to be contestable, a market must allow new entrants to enter and exit costlessly, *i.e.*, without incurring start-up costs, network investments, and other capital expenditures which commit the firm to remain in the market because those costs are “sunk” and cannot be recovered if the need to exit arises.<sup>13</sup> Economists have recognized that industries which have large capital requirements, and particularly those for which committed capital cannot be moved easily, tend to have high sunk costs and therefore are not likely to be contestable.<sup>14</sup>

While ILECs tend to argue that CLECs are able to avoid significant sunk costs in local exchange markets because they can resell ILEC services and/or

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<sup>10</sup> William J. Baumol, John C. Panzar and Robert D. Willig, *Contestable Markets and The Theory of Industry Structure*. New York: Harcourt Brace Jovanovich (1982). For an early criticism of contestability theory, see Shepard, W.G. (1984), “Contestability vs. Competition,” *American Economic Review*, 74: 572-587.

<sup>11</sup> See, *e.g.*, Berg, Sanford V., and Tschirhart, John, *Natural Monopoly Regulation: Principles and Practice*, Cambridge: Cambridge University Press (1988), at pp. 236-248, and James C. Bonbright, Albert L. Daniels, and David R. Kamerschen, *Principles of Public Utility Rates*, Arlington, Virginia: Public Utilities Reports, Inc. (1988), at pp. 161-162.

<sup>12</sup> Bonbright, et al., *id.*, at pp. 162-163.

<sup>13</sup> Richard Schmalensee and Robert Willig, *Handbook of Industrial Organization: Volume 2*, New York: North Holland (1989), at pp. 1303-1305.

lease unbundled network elements (“UNEs”) instead of building facilities, successful CLEC entry in fact requires substantial financial commitments and sunk costs even when the CLEC has resale or UNE options available to it. In order to overcome the ILEC’s near-100% legacy market share and brand recognition, any entering CLEC, even those that pursue a resale-only strategy,<sup>15</sup> must incur significant marketing, advertising, and other customer acquisition costs, many of which are not fungible. Non-resale-oriented CLECs must invest in a billing system and then either make very costly investments to build their own local exchange facilities or, more commonly, use UNEs. But even those CLECs choosing to use UNEs incur significant nonrecurring (and sunk) costs to collocate at ILEC wire centers, and make additional investments to have ordering systems that will interface with the ILECs’ operations support systems (“OSS”). In some cases, CLECs relying on UNEs also invest in their own complementary facilities, such as switches, which are also not likely to be fully recoverable if they exit the market.

Given this cost structure, there is little reason (and even less evidence) to believe that, as an economic matter,<sup>16</sup> potential competitive entry can exert any meaningful constraint on the ILECs’ pricing for local exchange service.

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<sup>14</sup> Schmalensee and Willig, *id.*, at pp. 1303-1305.

<sup>15</sup> Because resold services are priced at a fixed discount to the ILEC’s retail price level, resale-only CLECs can exert little pricing pressure on ILECs under either the traditional view or a contestable markets analysis.

<sup>16</sup> Finally, another factor that may limit applicability of the contestable markets theory to the local exchange is that state regulators may be reluctant to allow CLECs to repeatedly enter and exit the markets under their jurisdiction, especially when a quick exit may leave some customers without an orderly transition in their service and thus create consumer complaints.

**B. ILEC Special Access Prices and Rates of Return  
Demonstrate that Potential Competition Has Not Constrained,  
and Cannot Constrain, the ILECs' Exercise of Market Power**

The evidence filed in response to the *AT&T Special Access Petition*<sup>17</sup> demonstrates that neither the existing level of competition for special access services nor the threat of potential competition for those services has constrained the ILECs' exercise of market power in their local exchange and exchange access markets.

Special access services supposedly represent the most competitive segment of last mile connections that have historically been provided on a monopoly basis by the ILECs. Yet, as discussed in the Ad Hoc and AT&T pleadings described in Section I, *supra*, ILEC data indicate that the ILECs have increased, not decreased their prices for high capacity services in those areas where ILECs have been granted Phase II pricing flexibility,. In many cases, those prices are now higher than the prices for areas that are still regulated under price caps.<sup>18</sup>

Moreover, AT&T has filed data in support of its *Special Access Petition* which exposes astronomically high ILEC earnings levels for special access services. The data shows that earnings averaged in excess of a jaw-dropping 30% for special access services across all of the BOCs, and that those earnings have been increasing, not decreasing, over time.<sup>19</sup>

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<sup>17</sup> *AT&T Special Access Petition*, *supra*, note 5.

<sup>18</sup> See generally *Stith Declaration*, *supra*, note 6.

<sup>19</sup> See Declaration of Stephen Friedlander, *AT&T Special Access Petition* at Tab A ("*Friedlander Declaration*").

Ad Hoc's review of the record in that proceeding reveals that neither the pricing nor the earnings evidence has been credibly rebutted by the ILECs attempting to refute AT&T's analysis.<sup>20</sup> While Verizon proffered vague and unsubstantiated justifications for increasing its rates in "competitive areas,"<sup>21</sup> no BOC disputed AT&T's pricing evidence. But firms in truly competitive markets would not be able to raise prices and collect supracompetitive profits as the BOCs have done for special access prices without attracting competitors who would be able to take away customers by charging fully compensatory but far lower prices. Those BOCs that increased their special access prices above the fully compensatory prices set under the FCC's price caps regime clearly were not constrained by the threat of existing or future competitors eroding the BOCs market share.

The BOC's primary response to AT&T's earning evidence was to criticize it because it was based upon the regulatory data found in the Commission's ARMIS reports.<sup>22</sup> AT&T's initial evidence demonstrated steadily increasing rates of return for the Special Access service category, with returns ranging between 2.1% and 16.7% in 1996, and increasing to a low of 21.7% and a high of 54.6% for 2001.<sup>23</sup> More recent data reveals that the "average" BOC return on special

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<sup>20</sup> See generally Declaration of Lee L. Selwyn, AT&T Reply to Oppositions, FCC RM 10593, filed January 23, 2003 ("*Selwyn Declaration*").

<sup>21</sup> See Opposition of Verizon, FCC RM 10593, filed December 2, 2002, at fn. 58.

<sup>22</sup> Kahn and Taylor, BellSouth and Qwest, in documents filed in opposition to AT&T's petitions, also suggested that the inclusion of DSL revenues in the Special Access Revenue category skewed results. Dr. Selwyn, in his reply comments, calculated that adjusting for DSL revenues would only reduce overall return rates by a couple of percentage points. *Selwyn Declaration* at 46 to 58.

<sup>23</sup> See generally *Friedlander Declaration*, note 19, *supra*.

access services has continued to grow, increasing from an average of 29.3% in 2000 to a whopping 39.7% in 2002.<sup>24</sup> Returns of this level simply could not be sustained over a multi-year period in a mature market like that for local telecommunications service if it were fully competitive.

The BOC criticism of ARMIS data as a valid basis for evaluating interstate rates of return must be dismissed in this instance for a number of reasons. First, the ARMIS financial results simply document the costing and accounting rules that have been implemented by the Commission over several decades. The RBOCs themselves have had as large or larger a role in the development of these rules as any other party. If the rules and reporting requirements do not reflect reality, now is hardly the time to complain.

Second, while the ARMIS data may not be perfect (assuming, for example, that some costs and or revenues are under- or over-allocated to Special Access), that fact alone does not affect the trends in the data. In other words, even if the absolute rate of return developed for the special access category using ARMIS data is off by some percentage, the trend in the data (in this case steadily *up*) would nevertheless be a reliable indicator of the BOC's ability to increase prices to supracompetitive levels without fear of attracting competitive entry .

Finally, the probative value of BOC attacks on ARMIS is reduced considerably by the BOCs' own reliance on that data in other contexts. SBC, for example, maintained in its comments on the *AT&T Special Access Petition* that

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<sup>24</sup> See Rappoport, Taylor, Menko, and Brand, "Macroeconomic Benefits from a Reduction in

ARMIS data was not reliable for determining a rate of return at any category below total aggregated access services.<sup>25</sup> But in Federal District Court in Illinois, SBC relied on ARMIS results to prove that UNE rates were not covering their costs. SBC's expert witness, Dr. Debra J. Aron testified as follows:

Table 1 shows that SBC Illinois' average revenue per loop (for UNE-L) and revenue per line (for UNE-P) per month is substantially below the costs that SBC Illinois recognizes on its books to provide those UNEs. I used the FCC's financial accounting information as reported in its Automated Reporting Management Information System ("ARMIS") files to obtain the historical cost data specifically for SBC Illinois. These data are reported to the FCC for purposes of tracking the interstate rate of return and are subject to a highly detailed set of reporting guidelines.<sup>26</sup>

The Commission cannot ignore ARMIS earnings data on the basis of irreconcilable and patently self-serving claims that ARMIS is (1) reliable for determining the cost of a single disaggregated service element but (2) unreliable for calculating the aggregate (and excessive) rate of return for the entire special access category.

### **III. A DETERMINATION OF ILEC DOMINANCE IN LONG DISTANCE MARKETS WOULD BE PREMATURE**

The impending sunset of the separate subsidiary requirements applicable to the BOCs has caused the Commission to focus its attention prematurely upon whether the ILECs' long distance services should be classified as non-dominant. In all but a limited number of cases, the ILECs have only just begun provisioning in-region long distance service -- in almost 15% of states, the BOCs have yet to

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Special Access Prices," filed June 12, 2003 by Special Access Reform Coalition in RM 10593.

<sup>25</sup> See Opposition of SBC, filed December 2, 2002 in FCC RM 10593 at 21-23.

<sup>26</sup> See Affidavit of Debra J. Aron, PhD, filed May 27, 2003 on behalf of SBC in United States

enter the market at all.<sup>27</sup> Deciding that these carriers can be classified as non-dominant now is akin to deciding that someone will never get a speeding ticket by watching them pull the door shut on a sports car; it is simply too early to tell.

The economic impact of BOC entry into in-region long distance markets<sup>28</sup> is, in most cases, still evolving and difficult to evaluate as a factual matter. In those markets for which 271 authority has been granted and the BOC's in-region long distance affiliate has been in operation long enough to develop a market presence and marketing plan (generally less than a year), the in-region BOC long-distance provider appears to be able to dictate both the pricing levels and the scope of services being offered by its competitors, a classic indicator of market power. For example, Verizon received Section 271 authority in April, 2001 to begin offering in-region long distance services in Massachusetts. In only

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District Court for the Northern District of Illinois, Eastern Division, Case No. 03-C3290.

<sup>27</sup> Section 271 Authority was granted to Qwest in Minnesota on Thursday of last week (June 26, 2003), bringing the total number of jurisdictions in which 271 authority has been granted to 42 (including the District of Columbia). As of the end of 2002, certainly the most recent period for which any sort of aggregated market share data was available, Section 271 authority had yet to be granted to BOCs in 15 of the 50 states (fully 30%). According to Wireline Competition Bureau reports, BOCs were precluded from provisioning long distance service to approximately 25% of the subscribers in their local service areas at the end of 2002. See Industry Analysis and Technology Division, Wireline Competition Bureau, *Statistics of the Long Distance Telephone Industry*, released May 2003, Table 12.3.

<sup>28</sup> References are to BOC provision of long distance service *in-region*, because the BOCs do not compete in the long distance market out of region. SBC's website, for example, identifies "long distance" as a service offering only in those states within SBC's footprint for which 271 authority has been granted; long distance service is not among the service selection choices outside of SBC's ILEC footprint. The "Long Distance Overview" found in the "News Room" on the SBC website clarifies that service is only offered in the eight states in which SBC has been granted 271 authority, and that SBC "plans" include expansion to the remaining five states within its footprint once they receive 271 authority. No mention is made of offering service beyond the footprint. [www.sbc.com/new\\_room/](http://www.sbc.com/new_room/), accessed June 30, 2003. A search of Bell South's site reveals a similar approach. In its FAQ section, Bell South makes clear that a customer must be located within the Bell South footprint and also must presently be a Bell South Local Service customer in order to obtain long distance service from Bell South. [http://bellsouth.broaddaylight.com/bellsouth/dml\\_tsearch.pl](http://bellsouth.broaddaylight.com/bellsouth/dml_tsearch.pl), accessed June 30, 2003.



nine months, Verizon reported having acquired more than 20% of the interstate long distance market for customers located in Massachusetts.<sup>29</sup> While no recent statistics relative to Verizon's market share in Massachusetts are available<sup>30</sup>, all indications are that the percentage has continued to climb steadily.<sup>31</sup>

BOC market shares in other states for which information is available demonstrate growth at lightning speeds as well. Verizon New York reported a 20% market share after the first twelve months of offering in-region long distance service at the end of 2000,<sup>32</sup> and a 30% market share at the end of 2001.<sup>33</sup> While it did not report any state-specific market share numbers at year end 2002, it did declare itself the third largest long distance carrier in the United States,<sup>34</sup> a

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<sup>29</sup> See Verizon Press Release, "Verizon Communications Post Strong Results for Fourth Quarter, Provides Outlook for 2002," January 31, 2002. Unfortunately, Verizon no longer releases state-specific market share results.

<sup>30</sup> This Commission no longer requires the reporting of data that would allow it to evaluate the percentage of customers being served by any individual carrier or any class of carrier, either on a nationwide or state-by-state basis. Indeed, even the nationwide market share data reported by the Commission in the *Further Notice* at fn. 61 are gleaned from limited "bill harvesting" data collected by a privately owned company, TNS Telecom, which "donates" its databases to the Commission. This privately collected data is then given the imprimatur of official data when the Commission includes it, side by side with its own data, in a variety of formal reporting documents including the *Statistics of the Long Distance Telephone Industry* report cited above. The FCC's most recent report states that the amount of information available on the long distance industry has grown over the years because of the introduction of the Form 499-A revenue data now collected from all long distance providers. Unfortunately, the introduction of the Form 499-A in no way offsets the loss of the access minute and line count-based market share data which used to be available from the Commission. The Commission's final *Long Distance Market Shares* report was issued in 1999 when the collection of the underlying data was discontinued. The reliability and accuracy of the Commission's analyses of dominant/non-dominant issues would be better served by reinstituting the collection of some pertinent data by the Commission itself.

<sup>31</sup> See News Release *Verizon Communications Reports Solid Quarterly Results Bolstered by Demand for Wireless, LD, DSL and Bundles*, April 22, 2003.

<sup>32</sup> See Verizon Press Release, "Verizon Communications Post Strong Results for Fourth Quarter and 2000," February 1, 2001.

<sup>33</sup> See Verizon Press Release, "Verizon Communications Post Strong Results for Fourth Quarter, Provides," January 31, 2002.

<sup>34</sup> See Verizon Press Release, "Verizon Communications Reports Strong Yearly Operational Growth and Gives Outlook for 2003," January 29, 2003.

neat trick for a carrier that only began to compete three years earlier and didn't even have Section 271 authority in some of its states during the reporting period.

SBC's long distance market share growth appears to be no less stunning. SBC reported a 21% market share in Texas within the first year of offering in-region long distance service.<sup>35</sup> By the end of the first quarter of 2003, SBC's CEO reported close to a 50% market share for "consumer" long distance throughout its Southwest territory.<sup>36</sup> The rapid success of SNET's long distance offering in Connecticut is old news, with reports of a 60% SNET long distance market-share. Today, it appears that Connecticut was no fluke; SBC has indicated that it anticipates reaching the same market share percentage in every state in which it receives 271 authority.<sup>37</sup>

Given the reportedly rapid success of the BOCs in capturing in-region long distance market share, any evaluation of their place in the market in order to determine whether they should be classified as "non-dominant" would not be valid until their long distance operations have had a chance to fully mature. The Commission's classification of AT&T as non-dominant occurred after years of steady decline in its share of and control over the interstate long distance market. Similarly, the Commission should determine the appropriate classification of the BOCs' long distance services status as dominant players based on a valid time series of data. A determination made now, when BOC market shares and

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<sup>35</sup> *SBC Investor Briefing*, April 23, 2001

<sup>36</sup> Statement of Edward Whitacre, CEO SBC Communications, April 24, 2003 Conference Call Addressing First Quarter 2003 Earnings.

<sup>37</sup> SBC Investor Briefing analyst conference call, January 28, 2003,

market power is growing rapidly, would not be a sound basis for good public policy.

#### **IV. DOMINANT CARRIER SAFEGUARDS ARE NECESSARY TO ENSURE THAT ILECS DO NOT USE THEIR LOCAL MARKET POWER TO IMPEDE LONG DISTANCE COMPETITION**

The *Further Notice* seeks comment on the regulatory protections that the Commission could adopt to protect long distance markets from any anti-competitive harm that might occur once ILECs are able to provide those services on an integrated basis together with their regulated local exchange services. The Commission observes in the *Further Notice* that certain non-discriminatory provisioning and cost imputation requirements do not sunset after the Section 272 separate affiliate and related requirements sunset. But the non-discriminatory provisioning requirement has failed to ensure adequate and timely provisioning of the special access services needed by enterprise customers and their IXCs, as evidenced by the record in the Commission's *Performance Standards Rulemaking*.<sup>38</sup> And the imputation requirement in Section 272(e)(3) has very limited utility. Such a requirement prevents an ILEC from creating anti-competitive cross-subsidies from monopoly local services to more competitive long distance services by over-pricing local services and setting prices for long distance services below their access costs. But ILECs could set their long distance service prices above their access costs and still create anti-competitive and uneconomic price squeezes if their long distance prices do not recover their

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<sup>38</sup> *Performance Measurements and Standards for Interstate Special Access Services*, CC Docket Nos. 01-321, 00-51, 98-147, 96-98, 98-141, 96-149, 00-229, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001).

incremental costs of service besides access. Moreover, the ILECs could engage in any number of other anti-competitive or discriminatory practices, other than price squeezes, without some regulatory oversight.

Accordingly, Ad Hoc urges the Commission to adopt non-structural safeguards in both the local and long distance markets to protect competition in both markets.

1. Local Service Safeguards. With the elimination of structural safeguards, the Commission must, at a minimum, ensure that it can still detect and prevent price squeeze strategies by the ILECs, based on their continuing control of in-region access services, that would impede competition and harm end users. A narrowing of the price/cost margin for toll is not *per se* anti-competitive, of course, nor does it necessarily indicate unlawful pricing by an ILEC; it can be no more than the efficiency-enhancing consequence of increased competition in the long distance market. But competition and consumers would be harmed if shrinking margins are imposed disproportionately upon ILEC competitors solely because of above-cost pricing by the ILECs of the access services that they continue to control.

The most effective measure for preventing toll service/access service price squeezes is to ensure that access rates are at their underlying economic cost levels. Ad Hoc recognizes that the Commission has on several prior occasions emphasized the importance of ensuring the ILEC access rates are at the cost-based levels that would ordinarily prevail in a fully competitive access

services market.<sup>39</sup> The benefits of this approach are manifold. Moving BOC rates for access services closer to cost-based levels not only would improve the allocative efficiency of the downstream toll markets and ultimately bring lower toll prices to end users,<sup>40</sup> it would eliminate the ability of the BOCs to effect an anti-competitive price squeeze on competitive toll carriers in the in-region long distance market. If access charges are set at cost-based levels, the BOC and their rivals will be operating on a similar footing in providing toll service. The BOCs and IXC's will each be confronting roughly the same access costs, and will be able to compete on the basis of relative efficiency at converting wholesale access services, together with the value-added components, into a retail toll offering.

With the sunset of the Section 272 structural safeguards and the resulting opportunity and heightened incentive for ILECs to manipulate access rates and services to impede interexchange competition, cost-based and non-discriminatory access becomes crucial not only to emerging competition in local markets but to the preservation of robust competition in long distance markets as well. Accordingly, the Commission must turn to the issue of cost-based access pricing and take concrete steps to achieve cost-based access charges expeditiously.

Ad Hoc has previously identified a number of non-structural safeguards that would ensure ILECs are charging cost-based access rates. Chief among

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<sup>39</sup> See *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, Reform Order, 12 FCC Rcd 15982, 16001-04, paras. 42-43 (1997).

<sup>40</sup> *Id.*, 12 FCC Rcd at 16001.

these is the re-vitalization of price caps regulation for access services. As described in Section I, *supra*, the Commission's existing regime of pricing flexibility for special access services has proven to be premature because of the failure of competition to develop as the Commission had hoped when it adopted that regime for special access services. The ILECs have used the pricing flexibility granted to them under the existing rules to raise prices, confirming that significant countervailing competitive forces that could discipline market prices have simply failed to emerge. Accordingly, the Commission must re-impose its "price caps"/incentive regulation to ensure just and reasonable prices in the access services market.

In the Commission's earlier proceedings related to broadband competition,<sup>41</sup> Ad Hoc emphasized that its members were supporting re-imposition of price caps/incentive regulation only reluctantly. Ad Hoc noted that its members stand to benefit the most from de-regulatory initiatives because, as large users of telecommunications, they have the buying power to extract reasonable prices, terms, and conditions from the ILECs and thereby push down market prices for all when markets become competitive. And, as the biggest potential beneficiaries of de-regulation, Ad Hoc members have not been shy about demanding de-regulatory reform when market conditions justify it. But since those conditions simply aren't present in the access services market, Ad Hoc urges the Commission to:

- Enforce the non-discrimination, pricing, and tariffing requirements in

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<sup>41</sup> See note 2, *supra*.

Sections 201, 202, and 203 of the Act

- Initialize ILEC special access rates at the price cap-regulated levels in place before pricing flexibility authority
- Initiate and complete an X factor specification before the CALLS plan re-targets the X to GDP-PI in July 2004
- Continue the ILECs' contract tariff authority for access services so that ILECs and customers can negotiate in response to competition if it emerges

2. Long Distance Service Safeguards. The imputation requirement in Section 272(e)(3) establishes a limited safeguard against anti-competitive pricing of long distance services by an ILEC. In order to detect and eliminate violations of that requirement, however, the Commission must obtain data from the ILECs sufficient to police compliance. Accordingly, the Commission must adopt reporting requirements and revise its cost allocation rules to adequately monitor ILEC pricing of long distance services and ensure compliance with the statutory standard. Moreover, pending the adoption of price caps rules that can produce lawful access prices, the Commission should impose price caps on the ILECs long distance services rates to eliminate opportunities for cross-subsidies and price squeezes.

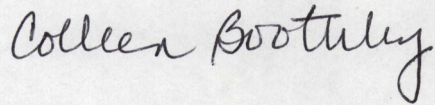
## **CONCLUSION**

As heavy users of both local and long distance services, the members of Ad Hoc support the Commission's objective of encouraging robust, competitive, and unregulated markets for local and long distance services. But a realistic assessment of current competitive conditions in the local services markets leads inevitably to the conclusion that some non-structural safeguards are needed, for

both the ILECs' local and long distance services, until local markets become more competitive. Where competition is too weak to protect consumers and competition from unjust and unreasonable rates, terms, and conditions, the Commission must intervene and adopt appropriate regulatory safeguards.

Respectfully submitted,

AD HOC TELECOMMUNICATIONS  
USERS COMMITTEE

A handwritten signature in cursive script that reads "Colleen Boothby". The signature is written in dark ink on a light-colored, slightly textured background.

By: \_\_\_\_\_

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### **Certificate of Service**

I, Algerlynn Gill, hereby certify that true and correct copies of the preceding Comments of Ad Hoc Telecommunications Users Committee were served this 30<sup>th</sup> day of July, 2003 via the FCC's ECFS system, and by email upon the following:

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A handwritten signature in black ink, appearing to read "Algerlynn Gill". The signature is fluid and cursive, with a large, stylized initial "A" and "G".

Algerlynn Gill  
Legal Assistant

July 30, 2003